Broads Authority

15 March 2024
Agenda item number 11

IFRS16- New accounting policy from 2024/25

Report by Director of Finance

Purpose

To update members on the implementation of IFRS 16 and provide a draft accounting policy for consideration

Broads Plan context

All strategic actions within the plan.

Recommended decision

i. To note progress on implementation.

ii. To approve the new IFRS 16 accounting policy from 1 April 2024.

1. Introduction

1.1. The International Accounting Standards Board (IASB) first published IFRS 16 Leases back in 2016. Private companies had to implement the new standard from 1 January 2019 and public sector was initially scheduled for 1 April 2022. The implementation for public sector had been delayed over a number of years partly due to COVID-19 but also in recognition to finance teams struggling with the external audit backlogs. In April 2022 CIPFA confirmed that adoption would be mandatory from 1 April 2024.

1.2. IFRS 16 Leases replaces the previous standard International Accounting Standard (IAS) 17 which dealt with how leases were categorised within the balance sheet. Under the old standard, leases were split between finance and operating leases. The main distinction being that finance leases were where the risk and reward transferred to the Authority and were included within the balance sheet. Operating leases were where the asset remained in the ownership of the landowner and rents were recognised via the income and expenditure statement. Although disclosed as note to the Statement of Accounts these were not recognised as assets or as a liability of the remaining lease payments.

1.3. IFRS 16 approaches leases from a slightly different angle and identifies assets where there is a right to use, including peppercorn leases. It removes the distinction between operating and finance leases for the Authority, where it is the lessee and excludes leases that run for less than 12 months.

1.4. This report was considered by Risk, Audit and Governance Committee on 12 March 2024. A verbal update will be provided at today's meeting.

2. Implications for the Broads Authority

2.1. As members are aware the Authority leases a proportion of its moorings. Under the old standard, some of these were considered as operating leases around the fact the land is normally considered a perpetual asset and the benefit of ownership remained with the landowner. A number of leases were classed as peppercorn leases which meant annual rent of £1 was considered immaterial and not recognised.

2.2. The Senior Accountant has undertaken a review of leases in preparation for 1 April 2024 implementation and 36 land/building leases have been identified. Under the transitional arrangements for the implementation of the standard leases can be recognised using the cost model (Initial lease liability + payments made before the lease start date – lease incentives received + Authority's direct costs + dismantling, removal and restoration costs) but only where lease is considered short term (under five years) and the lease provides for rent reviews for the amount payable to be updated to reflect current market conditions. Where these conditions are not met, including peppercorn leases the Authority's property advisors Norfolk Property Services (NPS) have been requested to value them at their current market value.

2.3. As highlighted in the Draft Capital, Treasury and Investment Strategy 2024/25 the introduction of IFRS 16 impacts the Authority's prudential indicators. The Right of Use (ROU) asset becomes an asset on the balance sheet and an unfunded liability of the outstanding lease payments. This in turn increases the Authority's Capital Financing Requirement (CFR) and its authorised debt limits.

2.4. At the time of writing NPS have completed the valuations for those leases that are revalued via CPI/RPI, but the peppercorn leases remain outstanding. This means a judgement has been made for those outstanding leases to calculate the CFR and debt limits for 2024/25. Of those valued £698,649 ROU assets and lease liabilities will need to be identified in the balance sheet. The most significant being Yare House (£470k) under the revised lease which is assumed to be in place for 1 April 2024. An additional £158,061 has been estimated for the peppercorn leases. This gives a total of £857,000 additional capital spend in 2024/25 and a liability of £699,000. The balance of the peppercorn leases will be identified as donated assets within the balance sheet and do not impact the CFR. All of the valuations will be subject to external audit review and any variations may require the estimates in the strategy to be revisited.

2.5. Previously, the Authority's authorised debt level had been £500,000 and the operational boundary debt set at £400,000. The previous Capital, Treasury and Investment Strategies had indicated that this may need to increase once the full implications of IFRS 16 was understood. The 2024/25 strategy proposes to increase these to £900,000 and £800,000, respectively. This is due to the current level of debt (PWLB) being predicted to be £94,000, which when combined with the £699,000 gives a potential opening balance of £793,000 which whilst it will reduce as payments are made the level may remain constant when leases are renegotiated.

3. IFRS 16 accounting policy

1.1. In order to formally implement the new accounting standard then the accounting policy within the statement of accounts needs to be updated and adopted. This would replace the existing wording for leases in the accounting policies. The 2022/23 wording can be found from pages 27-28.

1.2. The policy looks to quantify low value leases, in line with the Authority's capital de minimis level of £5,000 and does not include leases of less than 12 months. The draft wording for the new policy can be found in Appendix 1.

4. Conclusion

1.3. The preparation of IFRS 16 has required a large effort to understand and analyse the financial requirements of each of the leases. As with the introduction of any new standard there is always an element of judgement by the preparer in line with any guidance issued. As a new item in the 2024/25 Statement of Accounts this will be subject to external audit scrutiny.

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Broads Plan strategic objectives: All

Appendix 1 – Leases accounting policy

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xiv. Leases

The Authority as lessee

At inception of an arrangement, the Authority determines whether such an arrangement is or contains a lease. A specific asset is the subject of a lease if fulfilment of the arrangement is dependent on the use of that specified asset. An arrangement conveys the right to use the asset if the arrangement conveys to the Authority the right to control the use of the underlying asset.

The lease liabilities arising from a lease are initially measured on a present value basis comprising the following lease payments:

- Fixed payments (including in-substance fixed payments) less any lease incentives receivable.
- Variable lease payments that are based on an index or a rate, initially measured using the index or rate as at the commencement date.
- Amounts expected to be payable by the Authority under residual value guarantees.
- The exercise price of a purchase option if the Authority is reasonably certain to exercise that option.
- Payments of penalties for terminating the lease, if the lease term reflects the Authority exercising that option.
- Lease payments to be made under certain extension options.

The lease payments are discounted using the Authority's incremental borrowing rate, being the rate, the Authority would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

For the current year, the Authority's incremental borrowing rate for each tenor consists of Public Works Loan Board (PWLB) as this is the source of borrowing previously used.

The Authority is exposed to potential future increases in variable lease payments based on an index or rate, which are not included in the lease liability until they take effect. When adjustments to lease payments based on an index or rate takes effect, then the lease liability is re-measured using the changed cash flows and changed discount rate. Further, a corresponding adjustment is also made to the right-of-use asset.

Lease payments are allocated between the repayment of principal and a finance cost. The finance cost is charged to the Comprehensive Income and Expenditure Statement over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The right-of-use assets are measured at cost comprising the following:

- The amount of initial measurement of lease liability.
- Any lease payments made at or before the commencement date, less any lease incentives received.
- Any initial direct costs.
- Restoration costs.

The right-of-use assets are generally depreciated on a straight-line basis over the shorter of the asset's useful life and the lease term. If it is reasonably certain that the Authority will exercise a purchase option, then the right-of-use asset is depreciated over the underlying asset's useful life.

Payments associated with short-term leases and with low-value assets are recognised on a straight-line basis as an expense in the Comprehensive Income and Expenditure Statement. Short-term leases are leases with a lease term of 12 months or less. Low-value assets are items under £5,000 and comprise of IT equipment, small items of office furniture and low value land.

Peppercorn leases

Leases with payments at peppercorn or nominal consideration that are provided at substantially below market terms, and leases for nil consideration, are accounted for as follows:

- Any portion of the lease that is payable is accounted for in the same way as other lease obligations under IFRS 16 Leases
- The difference between the present value of any future lease payments due and the fair value of the lease on initial recognition is recognised as a fair value right-of-use asset on the Balance Sheet, with a corresponding gain recognised in grant income within the surplus or deficit recognised on the provision of services

The Authority has a number of leases over land and property under which it pays £nil or peppercorn rents. It has undertaken an exercise to assess the fair value of the assets leased under these arrangements through use of its property consultant, and these have been recorded in the financial statements, in respect of these leases.

The Authority as lessor

Operating leases

Where the Authority grants an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet. Rental income is credited to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement. Credits are made on a straight-line basis over the life of the lease, even if this does not match the pattern of payments (e.g. there is a premium paid at the commencement of the lease). Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the relevant asset and charged as an expense over the lease term on the same basis as rental income.